

**CIGARETTE TAX**  
**RCW 82.24**

Tax Base      The sale, use, consumption, handling, possession, or distribution of cigarettes; the tax applies to the first such taxable event which occurs within the state.

Tax Rate      The combined state tax rate currently totals \$1.425 per package of 20 cigarettes. (The federal government also levies a tax of 39 cents per pack upon cigarette manufacturers.) The \$1.425 state rate is comprised of the following:

- 23 cents. Receipts from this portion of the tax are deposited in the state general fund (RCW 82.24.020(1)).
- 8 cents. Proceeds are deposited in the water quality account and are used for various water-related programs (RCW 82.24.027). On July 1, 2021, the receipts are scheduled to be transferred into the general fund.
- 10.5 cents. Revenues go to the violence reduction and drug enforcement account to fund drug/alcohol programs (RCW 82.24.020(2)).
- 41 cents. Collections are deposited in the health services account (RCWs 82.24.020(3) and 43.72.900) and used to finance state health care programs.
- 60 cents. Receipts are deposited in the health services account. However, Initiative 773 also requires certain other distributions of these revenues, as described below (RCW 82.24.028).

Levied by      State

Administration      Department of Revenue. The tax is paid via the purchase of stamps which are affixed to each package of cigarettes by stamping wholesalers. Special licenses are required for sellers of cigarettes; fees for these licenses are paid to the Department of Licensing through the Master Business License application. Wholesalers subject to the cigarette tax are allowed compensation for their costs of affixing the stamps in an amount of \$6 per 1,000 stamps. Although the Department of Revenue administers collection of the tax, enforcement activities are performed by the Liquor Control Board. Legislation in 2003 required that out-of-state vendors of cigarettes must collect the tax on shipments to Washington purchasers, as well as report annually on the brands and number of cigarettes sold in the state.

Recent Collections (\$000)

<u>Fiscal Year</u>	<u>Collections</u>	<u>% Change</u>	<u>% of All State Taxes</u>
2004	\$336,156	2.0%	2.6%
2003	329,627	9.0	2.7
2002	302,337	23.6	2.6
2001	244,550	(2.2)	2.1
2000	250,109	(1.9)	2.1
1999	255,050	(1.5)	2.2
1998	258,870	1.9	2.3
1997	254,060	(0.8)	2.4
1996	256,071	26.8	2.6
1995	201,922	4.1	2.1

A breakdown of the FY 2004 cigarette tax collections (\$ in thousands) by account follows. This shows the initial collection of the tax receipts and does not reflect the final reallocation of the receipts per Initiative 773, as discussed below.

General Fund (23cents)	\$ 54,184
Water Quality (8 cents)	18,887
Drug Enforcement (10.5 cents)	24,956
Health Services (\$1.01)	238,128
Total FY 2004 Cigarette Tax	\$336,156

Distribution of Receipts

Receipts of the cigarette tax are distributed to the various accounts according to the rates as outlined above under the Tax Rates section.

Initiative 773, approved in November 2001, contains a reimbursement mechanism for several of the existing accounts. It requires that 10 percent of the funds derived from the new 60 cent tax be distributed each year to the tobacco prevention and control account for use in programs that reduce smoking among Washington residents. The remaining receipts of the 60 cent tax, after the reimbursements discussed below, will go to the health services account to be used for supplementing enrollment in the state's basic health plan.

The purpose of reimbursement of the violence reduction/drug enforcement account, the water quality account, and the health services account is to acknowledge that the additional 60 cent tax rate for health services could adversely impact the collections for the other funds, if taxable consumption of cigarettes declines as a result of the increase in overall tax rate. Thus, Initiative 773 specifies that the following dollar amounts shall be transferred from the receipts of the 60 cent tax to these accounts as follows:

**Violence Reduction/Drug Enforcement Account:**

2001-03 Biennium	\$6,497,500
2003-05 Biennium	\$7,789,000
Subsequent biennia	\$6,932,000

**Health Services Account (for the initial 41 cent tax):**

2001-03 Biennium	\$26,265,000
2003-05 Biennium	\$31,755,000
Subsequent biennia	\$28,622,000

**Water Quality Account:**

2001-03 Biennium	\$6,447,000
2003-05 Biennium	\$8,182,000
Subsequent biennia	\$7,885,000

**Exemptions, Deductions and Credits**

- Sales by wholesalers to persons in other states or countries.
- Sales to the federal government.
- Sales to Indians (via allocation program).

**History**

The cigarette tax was initially imposed as part of the Revenue Act of 1935 at a rate of 1 cent per package. The rate has been increased 17 times over the past 60 plus years. These and other major changes are summarized as follows:

- 1935 - Cigarette tax imposed at 1 cent per pack.
- 1939 - Rate increased from 1 to 2 cents per pack.
- 1949 - Rate increased from 2 to 4 cents per pack. Receipts from additional 2 cents earmarked for retirement of bonds issued to pay compensation to war veterans.
- 1955 - Additional tax of 0.5 cents per 10 cents of selling price (then roughly equivalent to 1 cent per pack). Receipts dedicated to public school building bond redemption fund until the bonds were retired, then to the general fund.
- 1959 - Rate increased from 5 to 6 cents per pack.
- 1961 - Rate increased from 6 to 7 cents per pack.
- 1965 - Rate increased from 7 to 11 cents per pack.
- 1971 - Rate increased from 11 to 16 cents per pack.
- 1972 - Bonds for veterans bonuses retired; compensation of \$250 extended to Vietnam veterans funded by the 2 cent rate (1949) until 1977 when the compensation was fully paid and the receipts began going to the general fund.
- 1975 - Previous exemption for possession of two cartons of unstamped cigarettes was repealed, thus strengthening cigarette tax enforcement.

- 1981 - Rate increased from 16 to 20 cents per pack.
- 1982 - Two surtaxes increased the rate from 20 cents to 20.8 cents (5/1/82) and to 23 cents (8/1/82).
- 1983 - Surtaxes adopted in 1982 made permanent.
- 1986 - Rate increased from 23 to 31 cents per pack. Receipts from additional 8 cents earmarked for water quality programs. Revisions to the Unfair Cigarette Sales Act; regulation of cost of cigarettes, to expire in 1991.
- 1989 - Rate increased from 31 to 34 cents per pack. Receipts from additional 3 cents earmarked for drug education and enforcement programs. The additional three cent rate was scheduled to expire on July 1, 1995.
- 1993 - Rate increase from 34 to 54 cents per pack. Receipts from the additional 20 cent tax earmarked for health programs; legislation includes rate increases for the following three years.
- 1994 - Rate increase from 54 to 56.5 cents per pack due to increase in the health services rate. Expiration of drug enforcement rate repealed and the 7.5 cent rate increase effective in 1995 is approved by both the Legislature and the voters (the only voter-approved tax increase under Initiative 601 to date).
- 1995 - Rate increased from 56.5 to 81.5 cents per pack due to 17.5 cent increase in the health services rate and 7.5 cent increase in the drug enforcement rate. Technical changes in the administration of the tax, including stamping of untaxed cigarettes for Indian consumption, tighter requirements for transporting cigarettes, and pre-collection of the tax in certain situations by Indian wholesalers.
- 1996 - Rate increased from 81.5 to 82.5 cents per pack due to 1 cent increase in the health services rate.
- 1997 - Enforcement of the tax shifted from the Department of Revenue to the Liquor Control Board.
- 1999 - One-half of the 8 cent tax for water quality is diverted to a new salmon recovery account for two years and the remainder of the water quality tax goes to the violence reduction and drug enforcement account for two years.
- 2001 - Legislation was adopted allowing the state to enter into contracts with 16 Indian tribal authorities (currently 21 tribes) relating to the imposition of tribal cigarette taxes. The intention is for a tribe to enact a tax equivalent to the state cigarette tax, thereby providing the tribe with revenues for tribal services and also reduce the incentive for evasion of the state tax.
- 2001 - Cigarette stamping allowance is increased from \$4 to \$6 per 1,000 stamps.
- 2001 - Initiative 773, approved in November 2001, imposes a new cigarette tax of 60 cents per pack, thus increasing the overall cigarette tax rate from 82.5 cents to \$1.425 effective January 1, 2002.

#### Discussion/Major Issues

Members of Indian tribes are not subject to tax on cigarettes sold on their reservation. The Department provides untaxed (but stamped) cigarettes to recognized tribes in an amount sufficient for the personal use of each tribal member, based on average per capita consumption rates. Non-tribal members have evaded the cigarette tax by purchasing

cigarettes from Indian stores. This tax evasion is being addressed through state/tribal agreements.

The \$1.425 cigarette tax rate now levied in Washington is among the highest in the nation. New Jersey currently has the highest tax rate at \$2.40 per pack, followed by Michigan at \$2.00. Rhode Island has a rate of \$1.71 followed by Connecticut and Massachusetts at \$1.51 and New York close behind at \$1.50. At the other end of the cigarette tax spectrum, 17 states, principally tobacco-producing southern states, have rates of 50 cents or less. At the bottom is Virginia's cigarette tax of 2.5 cents per pack and Kentucky's 3 cent rate. There is concern that Washington's high tax rate will continue to exacerbate the cigarette tax evasion problem, because most neighboring states have lower rates (Oregon, \$1.18; Idaho, 57 cents; California, 87 cents; and Nevada, 80 cents).

The Department estimates that evasion of cigarette tax amounts to roughly \$220 million per year (FY 2003) in lost tax revenues, including state/local sales taxes. Evasion is attributable to purchases at non-compact Indian tribal smoke shops by non-Indians, to purchases made in other states, or to purchases via the Internet or mail order. In addition to the loss of revenue due to tax evasion, the long-term trend in cigarette consumption has been declining in Washington and nationwide.

In the past, the cigarette tax has been used to fund bonuses paid to veterans and for retirement of school building bonds. Currently, the receipts are devoted to water quality improvements, drug programs, and health care, in addition to state general fund expenditures. There has been concern by some over the diversity of such programs funded by cigarette tax revenues and the lack of correlation between consumption of tobacco and the problems which these programs address.